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IN THE

Supreme Court of the United States

OCTOBER TERM, 1949

ATLANTIC COAST LINE RAILROAD COMPANY and the DEPOSIT COMMITTEE for First and Refunding Mortgage 5% Bonds of Florida East Coast Railway Company due 1974,

Petitioners,

vs.

ST. JOE PAPER COMPANY, ET AL.,

Respondents.

REPLY BRIEF OF PETITIONERS IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI

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The four respondents' briefs help to emphasize the importance of the questions presented by the petition, all of which are interrelated and but facets of a single question: How is the primary power in a Section 77 proceeding, to determine what a plan of reorganization shall provide, distributed among the Commission, the Courts and the security holders?

Although a series of decisions by this Court had sharply defined the distribution of power under Section 77 to determine what a plan of reorganization shall provide and had thus dissipated the fog of uncertainty which overhung Section 77 proceedings as a result of conflicting interpretations of that Section, the majority of the Court below undertook to redistribute that power and, by according to the District Court a broad and undefined discretion to determine "the broad equity and fairness"[1] of

[1] Brief of St. Joe Paper Company, p. 27.

a plan, construed Section 77 in such a way as to introduce into the reorganization machinery that very division of authority, with the attendant confusion, uncertainty, delay and risk of collision, which this Court found that the Congress had not intended.

It will not do to say, as the Conn group says (p. 13-14), that this question is not of great importance because there are only 29 pending railroad reorganizations or to conjecture that "before another crop of railroad reorganizations appear before the courts, it seems probable that the statute may be significantly changed." The conduct of 29 railroad reorganization proceedings is of public importance and there is no present move to change Section 77.

In view of the paramount importance of the dominant question which we have thus summarized, it is unnecessary to try to correct the many statements in the respondents' briefs which we deem clearly erroneous and unsupported either by the record or by anything in the opinions on which the respondents rely. Nor is it necessary to reply at this time to the miscellany of arguments on the merits of the case.

The Powers of the Commission and the Courts

This Court held in the *Western Pacific* case (318 U. S. p. 472)[2] that the "function of valuation" which is "left to the Commission is the determination of the worth of the property valued, whether stated in dollars, in securities or otherwise." The Commission made a finding of valuation, stated in dollars and Atlantic Coast Line securities, in the precise language of this Court's opinion in the *Milwaukee* case (318 U. S. 565-566),[3] that what the bondholders would receive would be "the equitable equivalent of the rights of these creditors in and to the property of the debtor" (267 I. C. C. 379).

[2] For fuller quotation see p. 17 of the petition for certiorari.

[3] For fuller quotation see p. 17 of the petition for certiorari.

The Courts below did not find that the Commission had failed to follow the statutory mandates or lacked material evidence to support its findings. Under the opinions of this Court which are summarized in the petition for certiorari the finding that the bondholders would receive "the equitable equivalent of the rights" which they would surrender was therefore conclusive.

The respondents, citing the majority opinions below, would circumvent the scheme of Section 77 and obliterate the division of authority between the Commission and the District Court. In their view, even though the Commission, which has the "leadership" (*Western Pacific* case, 318 U. S. p. 468), has properly discharged every statutory responsibility with respect to all components of a plan—public interest, valuation and distribution of securities—the plan may nevertheless be destroyed by an exercise of the Court's unfettered and independent judgment as to "the broad equity and fairness" of the plan.[4]

Specifically, the respondents take the position that as to "the equitable equivalence of the securities offered,—in short, the balancing of all 'private rights' along lines of fairness and equity in the allocation of securities,—the findings of the Commission are 'only advisory' to the Court, which should and will exercise its independent judgment."[5]

How do the respondents reach these conclusions, and what would be the consequences if the majority decision of the Court of Appeals so construing Section 77 should stand?

The respondents acknowledge that a valuation by the Commission is binding on the Court if made in conformity with the statutory mandates and supported by material evidence; the Mortgage Trustees aptly refer (p. 10-11) to

[4] Brief of St. Joe Paper Company, p. 27. See also Brief of Lynch interests, p. 16, and Brief of Conn group, p. 5.

[5] Brief of St. Joe Paper Company, p. 22.

"the Commission's essentially business evaluations of the worth of the Florida East Coast Railway". But, while professing to acknowledge that the Court should defer to such an essentially business evaluation, the respondents undertake to strip it of any significance. For they devote the greater part of their briefs to assertions that the consideration to be provided for the Debtor's properties under the Plan is inadequate.

At the same time they treat the requirement that a Court find that a plan is "fair and equitable" as authorizing the Court to exercise an "independent judgment" in determining whether the total consideration provided for a property is adequate. They do this by asserting that a question of "the absolute priority rule" was presented in this case,[6] even though there was no issue as to the respective treatment of a senior class and a junior class and none of the four Judges below mentioned the absolute priority rule. If this were the correct construction of Section 77, any question as to the adequacy of the consideration provided for in any plan for either all or any part of a debtor's property would present a question whether the plan was "fair and equitable" and the District Court would have the power and duty to decide independently as to the adequacy of the consideration.

In most reorganizations there are several classes of bondholders, each of whom is called upon to surrender a lien on a particular property in exchange for a smaller interest in an aggregation of properties, represented by securities which have been determined by the Commission to be the "equitable equivalent" of the rights which the bondholders surrender. This will appear from the tables in this Court's opinion in the *Denver* case (328 U. S. p. 502-503), from the opinion of the Court of Appeals for the Seventh Circuit in *Chicago R. I. & P. Ry. Co.* v.

[6] Brief of Conn group, p. 10.

Fleming (1946) 157 F. (2d) 241, at p. 247, and from even the most cursory examination of Commission-approved plans. The exchanges provided for in plans to which the respondents refer as "the allocation of securities'" present the most numerous, the most important and the most difficult questions of "broad equity and fairness" in railroad reorganizations. As to all those questions, the respondents support the view of the majority of the Court of Appeals that the District Court has the power and the duty to make determinations in the exercise of its "independent judgment" after receiving such evidence as it may see fit, whether or not such evidence was before the Commission.

Thus the respondents would adopt the "shuttle system" construction of Section 77. That was the name given to the construction of Section 77 advanced by some before this Court's opinions in the *Western Pacific* and *Milwaukee* cases, under which a plan would be shuttled back and forth between the Commission and the Courts until both agreed as to what was fitting and suitable under all the circumstances.

There can be no better illustration of the chaotic consequences of such an interpretation of Section 77 than is to be found in this case. The St. Joe Paper Company argues (p. 13) that the "effect of the order appealed from is thus to require the Commission to prepare a new plan of reorganization that will be more favorable to the bondholders than the instant certified plan." Yet none of the judicial opinions favoring a remand of the Plan contains the slightest suggestion as to how the Commission should go about preparing a "more favorable" plan—in what respects the present Plan is not favorable enough or in what respects and to what extent the treatment of the bondholders should be improved. The Commission having

[1] Brief of St. Joe Paper Company, p. 22.

determined that the present Plan is "fair and equitable", how can it tell what plan would appeal to Judge HUTCHESON as "really fair and equitable" (R. 948)? And it is absurd for the St. Joe Paper Company to assert (p. 13-14) that the outcome of a remand and ultimate action by the Commission a year or two hence, based on the record then available to the Commission, is certain to be a plan more favorable to the bondholders.

The Materiality of Opposition of Bondholders

As pointed out in the petition for certiorari (p. 26-28), Judge SIBLEY and Judge RUSSELL considered the opposition of the St. Joe Paper Company, the Claughton group, the Conn group and the Lynch interests fatal to the Plan. Judge HUTCHESON discounted the opposition of the St. Joe Paper Company and laid primary emphasis on the opposition of the Claughton group, the Conn group and the Lynch interests.

Having assumed a power to determine "the broad equity and fairness of the plan", those three Judges in effect delegated the power so assumed, either completely or in large measure, to a small number of opposing bondholders. As pointed out in the petition for certiorari (p. 26-28), all of the bondholders were entitled to have the Commission's determinations based on the record before it and upon its expert judgment, and, such determinations having been made in conformity with the statutory standards and with the support of material evidence, they should have been sustained.

Judge HUTCHESON's primary reliance on the opposition of the Claughton group, the Conn group and the Lynch interests as a basis for a remand of the Plan, pointedly illustrates one of the reasons why Judge HOLMES' criticism of the majority below (R. 952) was sound. The Claughton group has not opposed the petition for certiorari and there

is no basis for an assumption that it still holds any Bonds or, if it does, that it still opposes the Plan. This development suggests one good reason why there is "no provision of law for the court or judge to submit the plan to the creditors and to give any consideration before the vote is taken as to how the creditors will vote on it."

Changed Conditions

The brief of the Lynch interests, who have taken the lead in contending that there have been so-called "changed conditions", brings out clearly (p. 12-14) that, as stated in the petition for certiorari, the Judge Designate and the majority of the Court of Appeals made no distinction between

(1) evidence before the Commission;

(2) evidence relating to the period prior to March 25, 1948, which could have been, but was not, before the Commission; and

(3) evidence relating to the period subsequent to March 25, 1948.

The argument of the Lynch interests based on so-called "changed conditions" is really that the Court was empowered to decide whether the Commission correctly appraised the significance of any changes in conditions which took place from time to time over a period of years prior to the closing of the record before the Commission. It is simply a variation of the proposition for which all the respondents contend: that a District Court has a virtually unfettered "discretionary" authority to disapprove a Commission-approved plan if the Court believes that a class of creditors has not been suitably treated under the plan and in that connection the Court should form an "independent judgment" with respect to any matters which it deems relevant.

The contentions of the Lynch interests (p. 12) that the Commission "refused to reopen the record to receive evidence of permanently changed post-war conditions" and that the record did "not contain any evidence as to post-war conditions" were advanced in the Court of Appeals, but were demolished. The Commission's Report of March 25, 1948 shows on its face that it had and considered the most significant evidence of post-war conditions, i.e., the earnings records (267 I. C. C. 738-740).

The Contentions of the St. Joe Paper Company That the Petitioners Have No Appealable Interest

The St. Joe Paper Company contended in the Court of Appeals that the petitioners have no appealable interest and such contentions are now advanced in opposition to the petition for certiorari (p. 12-15). The contentions presented by the St. Joe Paper Company in the Court of Appeals were fully discussed in the briefs and they were so clearly insubstantial that none of the opinions of the Judges of the Court of Appeals mentions them. Those now advanced are equally without substance.

CONCLUSION

It is a matter of public importance in the administration of Section 77 proceedings that the conflict between the conclusions of a majority of the Court of Appeals and the decisions of this Court—a conflict sharply illuminated by the dissenting opinion of Judge HOLMES—be resolved.

If these proceedings were to be remanded to the Commission and the Commission were required to proceed in accordance with the opinions of the Judges who favor a remand, the will of Congress as set forth in Section 77 would be defeated and prolonged confusion, with respect to the reorganization of a Debtor which has already been in the hands of the Court for more than 18 years, would ensue.

It is respectfully submitted that the writ should be granted.

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